

# Developing Retrofit Financing Programs for Affordable Multifamily Housing



**TAP Webinar Series**

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# Overview

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- Background
- Challenges with multifamily weatherization
- Program design and implementation:
  - Use of program funds – grants, loans, administration, training
  - Opportunities for leverage and partnerships
  - Financial structures and credit enhancements
  - Possible lender requirements
  - Selecting and working with auditors and contractors
- Welcome to Dave Evans of Pennsylvania Housing Finance Agency

# A brief history...

Weatherization Assistance Program (WAP) established

Weatherization *Plus* strategy

Weatherization Innovation Pilot Program (WIPP)

Recovery Act funds WAP at \$ 5 billion



**1976-99**

- WAP-funded programs, significant level of multifamily activity in MN, IL, WA, NY in 1990
- See, Chicago Energy Savers Fund ('84-'89)
- Also, NY State utility program ('92-'95)

**2000-05**

- PG&E's Energy Action Program ('02-'06)

**2006-08**

- Cali. PUC: Designed for Comfort ('06-'08)
- Cook County Energy Savers ('07 ->)

**2009**

- Maryland Dept. of Housing & Comm. Dev.
- Enterprise Community Partners (CA, OH, WA, MA, NY)
- New Jersey HMFA
- NJ HMFA + PSE&G (ratepayer funded)
- Vermont HFA + Housing and Conservation Board

**2010-11**

WIPP, Better Buildings Initiative, & beyond...

**Sample not intended to be comprehensive. Emphasis on loan programs.**

Sources: National Housing Trust 2010, Ludwig et al 2008, Dyson et al 2006, Kinney et al 1997, MacDonald 1993.

# DOE's Multifamily Weatherization Efforts

- **Overall goal:** to overcome market barriers to energy efficiency investment in multifamily housing
- **Recent emphasis\*** on multifamily housing due to:
  - **Need:** approximately 70% of households living in multifamily housing are income eligible<sup>^</sup> nationwide
  - **Impact:** multifamily buildings are considered high residential energy users



\* See WPN 11-04 Guidance (December 22, 2010)

<sup>^</sup> DOE currently defines low-income currently as at or below 200% of the federal poverty level. Multifamily buildings with at least 2/3 of tenant households qualifying, can receive weatherization assistance under DOE programs

# Challenges with Affordable Multifamily Market

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- Split incentive barrier (tenant / landlord)
- Complex regulations governing rent and low-income utility allowances
- Long budget cycles and multiple layers of decision-making (developer / limited partners)
- Property owners may lack capital, personnel, and resources to devote to energy efficiency improvements
- Investor risk:
  - Properties may have complex ownership structures
  - Loan-to-value ratio may be too high to take on more debt
  - Subordinate position on debt may be expected

Source: Dyson et al. 2006 ACEEE Summer Study.

# Property Owners: Priorities and Constraints

- For-profit and non-profit affordable housing property owners alike have constraints and competing priorities

Maintaining  
Affordability

Repairs / Asset  
Management

Modernization

Budget Cycle Constraints

Favorable Loan Terms?  
Developer's Fee?



State Regulations

Existing **Debt**

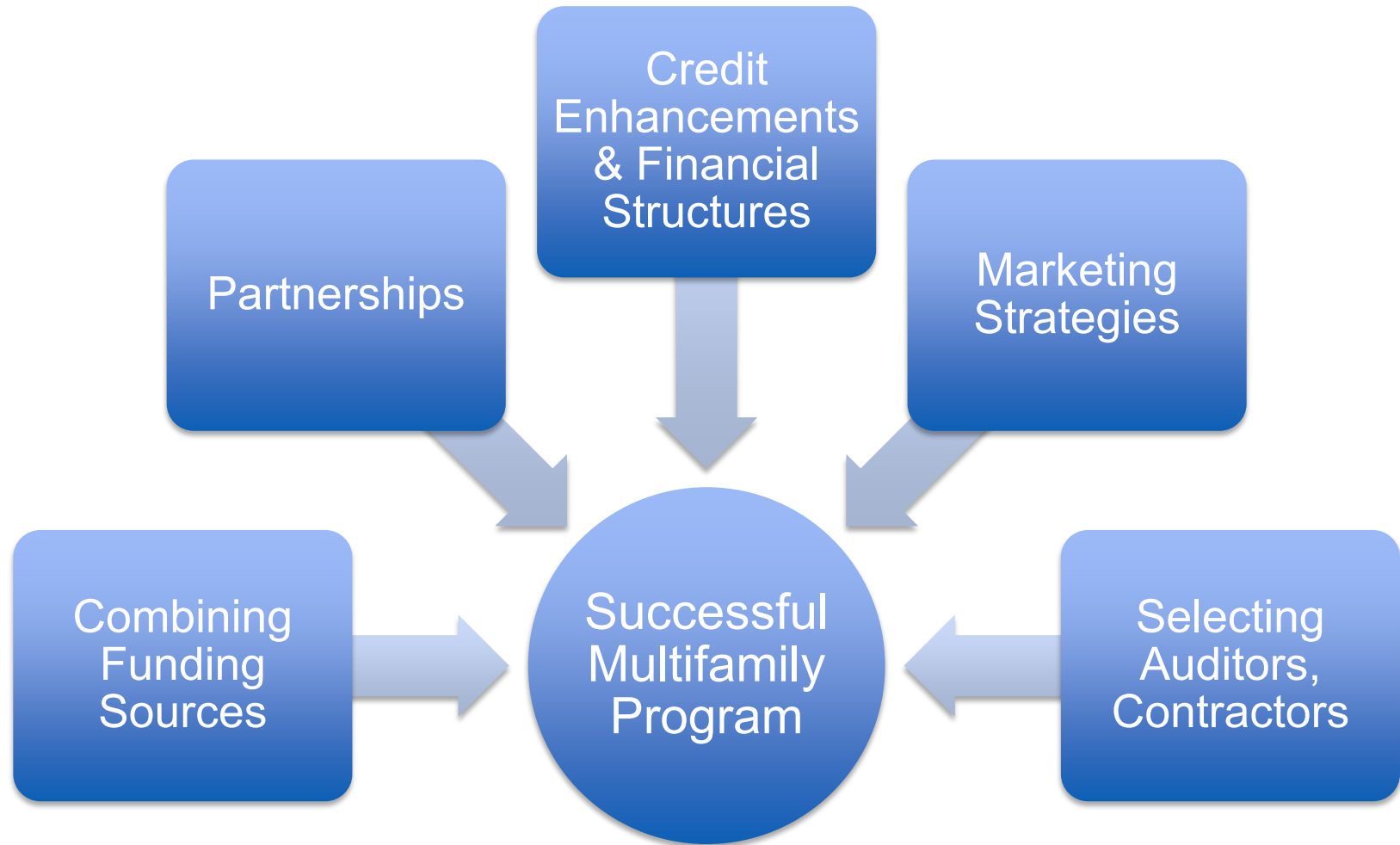
Shareholder  
Requirements

Increasing Utility Bills

Limited Resources



# Essential Program Elements



# Leverage Opportunities

- Programs typically **combine multiple funding sources**:
  - DOE weatherization funds (i.e., WAP, Recovery Act, WIPP)
  - Grants from private foundations (e.g. MacArthur Foundation)
  - State/ utility buy-down incentives (e.g. SBC funds, utility funds)
  - Other federal funds: USDA's Rural Development program, HUD Home Funds, Community Development Block Grants
  - Funding from partnering financial institutions (CDFIs, Federal Home Loan Bank, community banks, and private banks)
- Funds can be used for:
  - Program administration
  - Training auditors
  - Subsidizing investment grade audits (IGAs)
  - Grants or buy-downs
  - Credit enhancements for making low-interest loans available



# Partnership Opportunities

## Program administrator

- State agency, (e.g. housing finance authority (HFA), dept of commerce, housing, community dev.)
- Utility
- Consultant firm
- Non-profit

## Capital provider

- HFA
- Community development financial institution (CDFI)
- USDA – Rural Development
- Federal Home Loan Bank
- Utility ratepayers
- Other private capital





# New Jersey – Partnerships Example

- PSE&G proposal as a way to meet state EE requirements
- Partnership with New Jersey Housing & Mortgage Finance Agency (HMFA) considered key to success
- No DOE funding, 100% ratepayer funded

## PSE&G (utility)

- Co-markets the program
- Screens properties according to utility repayment history
- Reviews contractor bids and conducts a final assessment on payback and savings
- Issues money to building owner in three installments
- Enables **on-bill repayment over 10-years at 0% interest**

## New Jersey HMFA

- Key to PSE&G program approval by state regulators and customer acceptance
- Facilitates marketing by screening and recruiting properties
- Advises building owners during meetings with contractors
- Conducts underwriting analysis

# Credit Enhancements and Financial Structures

- Subordinated/ Senior Capital Structure
  - The use of funds to provide subordinated capital covering a fraction of the loan
  - Subordinated capital absorbs first losses
  - Permitted use of WIPP funds
- Loan Loss Reserve Fund
  - Typically used with portfolios of small, unsecured loans
  - Not permitted use of WIPP funds
- Loan Guarantees (full / partial)
  - Similar to a Loan Loss Reserve, but uncapped
  - Not permitted use of WIPP funds
- Third-party Loan Insurance
  - May be an expensive option
  - Not permitted use of WIPP funds





# SF Bay Area Multifamily Green Retrofit Program – Financial Example

- Enterprise Community Partners provides unsecured loans to multifamily properties in the SF Bay Area
- DOE State Energy Program (SEP) funds are used to provide “top loss” or subordinate capital (50% of the pool)
- The other 50%, senior debt, was sought from private financial institutions
- The senior hard debt was acquired at a low interest rate. With the SEP capital, the blended interest rate for retrofit loans is 5%, over a 10-year term.
- The loan fund manager’s experience over the last 1.5 years indicates that >50% credit enhancement might be required to attract private lenders and create a loan product attractive to owners of affordable multifamily housing

# Possible Loan Program Requirements

- Investment grade audit, (using DOE-approved TREAT or EA-QUIP audit protocols\*)
- Loans sized according to energy savings
- Savings-to-investment ratio threshold for improvements
- Lien on property (secured loan)
- Replacement reserves / % owner contribution
- Debt service coverage ratio of ~1.15-1.25
- Requirement that property be maintained as affordable housing for X years
- Energy savings guarantee (see next slide)



\* More information on audits: <http://www.waptac.org/Energy-Audits/Multi002DFamily-Audits.aspx>



# Service Provider Model: Obtaining a Guarantee of Energy Savings

- Energy Service Companies (ESCOs) have been long-used in the public sector as retrofit contractors:
  - *ESCOs provide the benefit of energy savings guarantees for projects*
- State multifamily programs can potentially partner ESCOs:
  - Under this model, property owners would select an ESCO to complete work
  - Energy savings guarantee may enable low-cost, long-term financing
- Multifamily retrofit programs have considered working with ESCOs:
  - Chicago Multifamily Energy Retrofit Program (ARRA) (*ultimately program did not materialize*)
  - Stewards of Affordable Housing for the Future (WIPP) (*under implementation now*)



# Marketing Strategies

- Direct mail letter, outreach, seminars, and workshops for property managers
- HFAs can identify and target specific borrowers in their portfolio
- Connection with HUD, USDA, and other lending entities, who may:
  - Share database of properties
  - Directly assist in marketing
- Energy auditors can be used to spread the word



## ***Screening Criteria:***

- Age of property,
- Need for energy retrofit,
- Need for broader rehabilitation,
- Financial stability,
- Ownership structure,
- OR, first-come, first-served

# Selecting and Working with Auditors and Contractors

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- Auditors:
  - Program Administrator often issues a request for qualifications (RFQ)
  - Qualifications typically include similar auditing experience, familiarity with TREAT or EA-QUIP, Buildings Performance Institute accreditation
  - Program Administrator can conduct an RFP for particular properties, or property owners may need to solicit quotes themselves
  - Depending on jurisdiction: auditors may need training
- General Contractors/ Architectural Engineering Firms:
  - Qualifications typically include quality workmanship, experience with contracts of this size, financial capacity to carry costs for a defined duration while awaiting payment
  - Firm typically selected through a public bidding process
  - Third-party inspection is typically performed before final payment is issued

# Pennsylvania Housing Finance Agency (PHFA) - Auditors/Contractors Example

- Part of MacArthur Foundation grant was used to train 33 engineering firms on multifamily auditing
- Auditors are pre-approved and listed on PHFA Website
- Property owners must solicit at least 3 quotes from auditors
- PHFA selects arch. engineering firm through an open bidding process
- PHFA conducts final inspection

## Preservation Through Smart Rehab Program

[E-mail Us](#)

### Energy Auditors

To search for an Energy Auditor in your area, please choose a county in the dropdown box or map below.

#### DROPDOWN SEARCH OPTION

\* Opens in a new window. Pop-up's must be allowed for this site.

#### MAP SEARCH OPTION



\* Opens in a new window. Pop-up's must be allowed for this site.

# NREL's RE Project Finance Website

## http://financeRE.nrel.gov

**Renewable Energy Project Finance**

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- A [weekly blog](#) highlighting analysis from NREL
- An [upcoming events](#) listing from a variety of conference and Webcast organizers.

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**PPA Checklist for State and Local Governments**

This fact sheet provides information and guidance on the solar photovoltaic (PV) power purchase agreement (PPA), which is a financing mechanism that state and local government entities can use to acquire renewable energy.



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**Market Insights Blog**

[Staying \(Cash Flow\) Positive: Investor Requirements for RE Project Financing](#)  
Karllynn Cory - November 8, 2010

[Developers and Investors Doing "Flips" for Government Tax Incentives: A Discussion of Partnership Flips](#)  
Paul Scharfenberger - November 1, 2010

[Peeling the Onion: The Layers of Capital Structures](#)  
Paul Schwabe - October 25, 2010

[Coordinate, Collaborate, Innovate: the Case of California Act Funds](#)

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# NREL Website – Original Content

<http://financeRE.nrel.gov>

## Weekly Blog Articles

- *Do New Dodd-Frank Regulations Impact REC and Allowance Markets?*
- *Solar Development May be Hampered by Proposed New Accounting Rules*
- *A California Utility Seeks to Invest In Montana Wind*
- *U.S. DOE Releases New Solar Procurement Guide for Federal Agencies*
- *Wanna Improve Financing of RE Projects? Include a Charitable Organization*
- *Staying (Cash Flow) Positive: Investor Requirements for RE Project Financing*
- *Grazing in the Grass? Making Sense of the New BLM Rate Structure for Solar Projects*

## Regular Feature Analyses

- *Power Purchase Agreement Checklist for State & Local Governments*
- *DOE's Loan Guarantee Program: A Primer*
- *First Known Use of QECBs will Save Yolo County at least \$8.7 Million over the Next 25 Years*
- *NREL's Renewable Energy Project Finance Tracking Initiative (REFTI)*

# Questions?



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